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Brisbane Australia

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Price partitioning and people-processing services: Does service unbundling lead to retaliatory customer behavior? – An empirical investigation in the airline industry

Sven Tuzovic, Pacific Lutheran University
Merl Simpson, Pacific Lutheran University
Volker Kuppelwieser, University of Wuppertal
Joerg Finsterwalder, University of Canterbury

Introduction

Although pricing is often described as the least understood and most ineffectively applied element of the marketing mix, it is critical to business viability. Effective pricing is essential to financial success, providing the necessary revenue for all other marketing and operational activities, as well as profits for reinvestment and shareholder interests (Lovelock and Wirtz 2011). As Kotler and Keller (2012) observe, “price provides revenue ... other (marketing mix) elements produce costs.” A common pricing method is “price bundling” which means that providers combine several products or (complementary) services offering the bundle for a single, combined price (Ancarani et al. 2009; Armstrong and Kotler 2011). Businesses in manufacturing and service industries employ this practice to enhance appeal to customers, and thereby improve revenue and profitability, for instance, McDonald’s “Happy Meals” or automobile sales that include periodic maintenance and roadside service.

Price partitioning, on the other hand, refers to the practice of intentionally splitting a “combined price” into several components (Ancarani et al. 2009; Fruchter, Gerstner and Dobson 2010). In recent years, businesses have started to charge fees for services that were previously provided for free (Fruchter, Gerstner and Dobson 2010). According to Morwitz et al. (2009, p. 6) partitioned pricing “is now being used in more situations, and in more sophisticated ways, than ever before.”

The airline industry, in particular, has attracted considerable attention in the media by effectively “unbundling” services in separate elements formerly included in airfares and instituting a panoply of ancillary fees (Vinod and Moore 2009). While the move from “free to fee” has been previously observed in various people-processing industries (banking, hotels, etc.), airlines have become increasingly creative in charging passengers for items they once provided for free (Mouawad 2010). For example, premium and full-service airlines in the United States and elsewhere have introduced a variety of “ancillary fees” for checked baggage, priority seating, itinerary changes, flying standby, food and drinks, pillows, pet transportation, etc., although some of those fees are waived for members of the airline’s frequent-flier program. Airlines call these charges “ancillary revenue opportunities” (Barth 2010). Such fees have now become a significant source of airline revenue (Yamanouchi 2010). According to reports by the International Air Transportation Association (IATA) and the Centre for Asia Pacific Aviation (CAPA), the airline industry is expected to generate \$58 billion in ancillary revenues worldwide to-date (Barth 2010; Grossman 2010).

As widely reported in the media, a predictable consequence of the drastic departure from “bundled” pricing practices has been widespread frustration, public displeasure, anger and forms of retaliation. However, while there has been considerable attention devoted to this topic in the news media, academic research study is lacking about the relationship between ancillary fees and customers’ emotional and behavioral responses.

This study seeks to investigate the effects of partitioned pricing practices and ancillary fees in the context of people-processing services, such as airlines, hotels, etc. Drawing on justice theory we develop a retaliatory behavior model that is tested among a sample of customers of a large travel agency in the United States.

Research context

The airline industry, in particular, is chosen for this research context. Confronted by long-term industry financial losses, and struggling to re-establish profitability, carriers are “desperate for new income” (Barth 2010). In 2009, U.S. airlines collected a record of \$7.8 billion in revenue from such discretionary fees (Orwoll 2010), which according to the International Air Transportation Association (IATA) have accounted for more than twelve percent of airline revenues, exceeding \$58 billion worldwide to-date 2010 (Grossman 2010). Significantly, the Internal Revenue Service declared fees not to be taxable; a further benefit to the airline balance sheets (Hughes 2010).

While research provides a rationale for charging additional fees for particular services, e.g. cancellation fees or carrying excessive luggage, in order to reduce customer abuse customer-friendly services (Fruchter and Gerstner 1999; Hess, Chu and Gerstner 1996), the “cornucopia of new fees can feel maddeningly complicated” (Mouawad 2010). Air passengers in general are sensitive to airline travel cost (Martin, Roman and Espino 2008). And while some fees, e.g., for onboard purchase of food may be tolerable to many travelers, according to an online survey of 1,396 travelers by the Consumer Travel Alliance (CTA), the Business Travel Coalition (BTC) and the American Society of Travel Agents (ASTA), customers have experienced widespread surprise and anger over airline fees for services such as telephone reservations, checked baggage, seating and priority boarding. A new website named MadAsHellAboutHiddenFees.com has been launched that will “allow travelers to tell their own hidden fee stories, create YouTube videos, and sign a petition to the U.S. Department of Transportation (DOT) urging...action to require airlines to disclose those fees in advance....” (Koumelis 2010).

In addition, research shows that brand attitudes of consumers decrease, after they realize that they misestimated the total of partitioned prices while attributing that error to the provider (Lee and Han 2002). While low-cost carriers such as JetBlue can get away with cutting prices and then charging extra for additional services, the question is when premium carriers will suffer from brand damage or, ultimately, generate enough momentum for fee-disclosure legislation (Barth 2010).

Research Model and Hypotheses

Based on justice theory and literature on service bundling and price partitioning, we propose that partitioned pricing and ancillary fees lead to strong negative emotions, which in turn will result in avoidance intentions and retaliatory customer behavior. Figure 1 shows the specified research model.

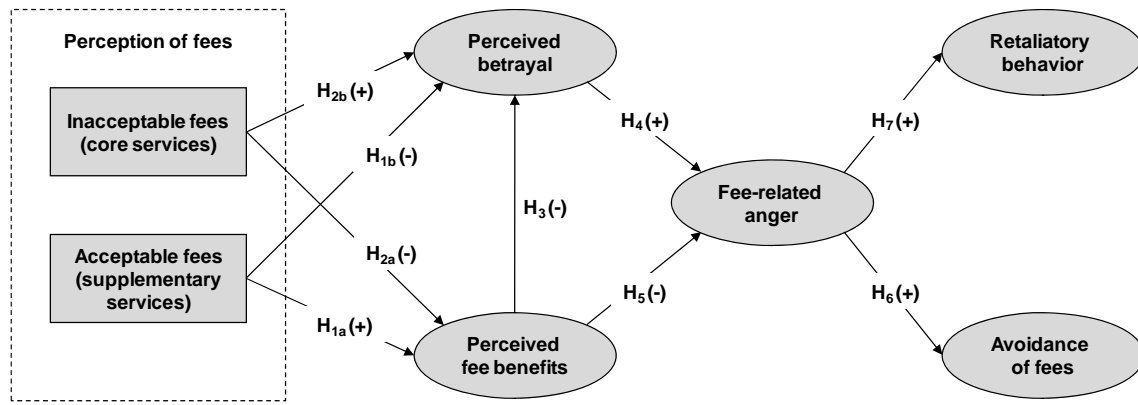


Figure 1: Research model and hypotheses

Methodology

To test our research model, we collaborated with a large travel agency in the U.S. Due to privacy guidelines the travel agency was responsible for contacting prospective respondents and inviting them to participate in an online survey. A pre-tested questionnaire was sent out via email to 4,000 customers. The introductory email was followed up 15 days later with a reminder. We received 464 responses yielding a response rate of 11.6%. After performing missing value analysis we had to delete 41 cases, resulting in a final data set of 423 customers. Most measures are influenced or adapted from the literature. 7-point Likert scales were used, anchored by “strongly disagree” (1) and “strongly agree” (7). All factor loadings are highly significant and the construct reliability exceeds .70 for every construct. This indicates convergence or internal consistency of the constructs. Furthermore the AVE was larger than the SIC for each pair of variables, which provides evidence for discriminant validity (Fornell and Larcker 1981). We undertook several steps to examine the impact of CMV and the effects of multicollinearity on our results are negligible.

Results

The results indicate that ancillary fees lead to “justice-based” retaliatory behavior, e.g. vindictive complaining, negative word-of-mouth, and third-party complaining for publicity. The results also indicate that these fees lead to “avoidance behavior” which supports anecdotal comments from passengers in the news media. Table 1 shows the results of the structural equation model.

Table 1: Results of structural models^a

	Supplementary fee model	Core fee model
Fee acceptance → Perceived fee benefits	.16**	.299***
Fee acceptance → Perceived betrayal	-.137*	-.136**
Perceived fee benefits → Perceived betrayal	-.408***	-.389***
Perceived fee benefits → Fee related anger	-.198***	-.198***
Perceived betrayal → Fee related anger	.48***	.479***
Fee related anger → Retaliatory behavior	.62***	.62***
Fee related anger → Avoidance	.317***	.317***

Core fee model fit: $\chi^2/df = 2.461$, IFI = .944, TLI = .934, CFI = .944, RMSEA = .059;

Supplementary fee model fit: $\chi^2/df = 2.185$, IFI = .945, TLI = .935, CFI = .944, RMSEA = .053;

^a $n = 423$, two-tailed significance tests, *** $p \leq .001$, ** $p \leq .01$, * $p \leq .05$

Conclusions

Our research results provide important implications both for research and management. First, our study contributes to research as it provides insight into airline passengers' reactions to the now common practice of airline ancillary fees. Our findings support the widespread perception which so far has been based solely on anecdotal evidence that airline fees may lead to anger, retaliatory behaviour and avoidance tactics. This research contributes to the body of service marketing literature as it extends the context of when customers feel to be betrayed in the context of people-processing services. While previous work assumed a service failure, our research suggests that pricing techniques in a non-failure service encounter may lead to betrayal and negative emotions. Our research also supports the argument that betrayal is a key motivational factor for customers to restore fairness by all means, including various forms of retaliation (Grégoire and Fisher 2008).

Although this research confirms anecdotal evidence that travellers experience a sense of betrayal and anger for imposed services fees, and many strive to retaliate against carriers, the efficacy of such behaviours is doubtful. The collective ancillary revenue earned by airlines would give little suggestion that consumer complaints and negative opinion would result in a different pricing strategy. However, it can equally be said that the airlines have not recognized the public relations consequences of such a drastic pricing strategy change, failing to educate consumers to the realities of airline travel and to the value being created by branded travel products and unbundled pricing, by which a passenger chooses and pays for desired amenities rather than some being subsidized by others for their use. In accordance with previous studies (e.g. Grégoire and Fisher 2008) it is important to point out that the potential costs of customer retaliation can be significant. However, we also acknowledge that, realistically, travellers have few viable alternatives, especially for long-distance or intercontinental travel, wherein such a large percentage of airlines increasingly employ such fees.

References

References are available to the reader upon request.